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E.O. 12958: N/A

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SUBJECT: WILL THE ALAN GREENSPAN OF TURKEY BE REPLACED?

Ref: Ankara 7210

This cable was coordinated with Congen Istanbul.

¶1. (SBU) Summary: Many observers have worried that the AKP Government may replace Central Bank Governor Sureyya Serdengecti when his term expires in March. Our view -- supported by Serdengecti himself -- is that even if PM Erdogan decides not to reappoint the founding father of Turkey's independent monetary policy and a key figure in the post-2001 economic recovery, it can minimize markets' disquiet by announcing a qualified successor well in advance. If it doesn't, or if it announces an individual deemed unqualified, markets will react negatively at a time when Turkey needs to be signaling to the world its commitment to continued sound monetary and fiscal policies. End Summary.

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Serdengecti's Tenure Up for Renewal  
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¶2. (SBU) Central Bank Governor Sureyya Serdengecti's tenure comes up for renewal in March 2006. In the press and in the markets, speculation is building about a) whether the GOT will reappoint Serdengecti, and b) if not, who might replace him. At this point, barring serious market turbulence between now and March, both the grapevine and the track record suggest that Prime Minister Erdogan will opt to replace Serdengecti with someone with closer ties to the AK Party Government.

¶3. (SBU) In the past, when presented with an opportunity to replace officials heading up independent agencies, like most governments around the world, the GOT has moved to put its own people in charge. In Serdengecti's case, senior officials have often betrayed their irritation with the Governor's vigorous assertion of the central bank's independence and his readiness to "keep them honest" on economic policy. Serdengecti has related to us more than once the guerilla war he has had to fight against senior officials who want to rein the bank in.

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The GOT and Central Bank Independence  
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4.(SBU) GOT leaders lack a deep understanding of the importance of an independent monetary policy, despite Turkey's disastrous history of political interference. Ministers such as Economy Minister Babacan, who has to

work with the IMF, understand the issue. Other Ministers -- notably Trade Minister Tuzmen -- and AK Party politicians often criticize the Central Bank's interest rate policy, which they claim has led to an overvaluation of the lira. Meanwhile, Serdengecti himself has worked hard to achieve a modus operandi with the GOT, particularly with Babacan but also with some success with Prime Minister Erdogan. Nevertheless, with exporters continuing to decry Central Bank policies, and political pressure on the PM to take advantage of the opportunity presented by the expiration of Serdengecti's mandate, the AK Government will most likely opt for one of its own.

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Serdengecti's Impressive Record  
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15. (SBU) The former coalition government appointed Serdengecti in the immediate aftermath of the 2001 crisis. He is widely credited by financial markets and international financial institutions as the man who brought Turkey's runaway inflation down to single digits. "The Banker" magazine named him 2005 Central Banker of the year. Serdengecti also presided over the successful currency changeover to the New Turkish Lira, and in December 2005 announced the introduction of formal inflation targeting in 2006. As a known quantity, a competent Central Banker and an ardent defender of the floating exchange rate regime, Serdengecti would certainly be the preferred candidate of markets and the IFI's.

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Who would they Pick?

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16. (SBU) If the GOT opts to replace Serdengecti, speculation is rife about who they would pick. Among the leading candidates being mentioned:

--Ibrahim Canakci. Treasury Under Secretary Canakci has been Babacan's right-hand man, and lead economist, successfully pushing through (most) IFI conditionality and deserving much of the credit for Turkey's much-improved macroeconomic situation. Having held jobs in three key economic agencies (Banking Supervision, State Planning, and Treasury) Canakci is highly respected and his appointment would likely be acceptable to markets.

--Erdem Basci. A Vice-Governor of the Central Bank since 2003, Basci is the only one of the Vice-Governors selected by the AKP Government. Reputedly close to Minister Babacan, Basci is a PhD economist who did graduate work at Johns Hopkins and is generally well-regarded by other economists, including Serdengecti himself. At the Bank, Basci has been a loyal defender of Bank policies. At 39, Basci is on the young side, but the GOT has made several high-level appointments that many considered too young for the job: notably Babacan and BRSA Chairman Tefvik Bilgin.

--Adnan Buyukdeniz. The General Manager of the Islamic finance house Al-Baraka Turk has been mentioned in big business circles as a contender. Appointing the head of an Islamic finance house to manage interest rates is likely to raise eyebrows -- or worse--within Turkey's secular establishment. Though lacking the policy experience of Canakci or Basci, Buyukdeniz is a graduate of the London School of Economics.

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Serdengecti's Take  
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17. (SBU) In a recent meeting, Serdengecti said that it was the Prime Minister's prerogative to replace him, if he so desired. However, he said the most important point was that the PM make a decision quickly so that Serdengecti could help prepare his transition. Serdengecti expressed admiration for the way the U.S. is handling the change in chairmanship at the Federal Reserve Board, with an early announcement of a highly qualified person allowing plenty of time to manage a smooth transition.

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COMMENT  
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18. (SBU) Most analysts expect 2006 to be a more difficult year for Turkey's economy. Meeting the 5% inflation target will be challenging in itself, and Turkey's 6% of GDP current account deficit and large foreign currency-linked debt stock leave it more exposed than other emerging markets to a contraction in global liquidity. At the same time, Turkey reduces its exposure by signaling to world markets its ongoing commitment sound monetary and fiscal policy. The IMF program and EU accession process are important "anchors" in this regard. But Serdengecti himself, who -- as is repeatedly reaffirmed to us by bankers and businesspeople -- is personally credited with "slaying the inflation dragon" (ref), is another key anchor of credibility. Managing a transition will be delicate, and the government is well advised by Serdengecti to announce its intentions soon, whatever it intends to do.  
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